

Spring 2012



Report of the Auditor General of Canada to the House of Commons

CHAPTER 6

Special Examinations of Crown Corporations—2011



Office of the Auditor General of Canada

OAG

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Ce document est également publié en français.

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Cat. No. FA1-2012/1-6E-PDF

ISBN 978-1-100-20144-3

ISSN 1701-5413

CHAPTER 6

Special Examinations of Crown Corporations—2011

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Special Examinations of Crown Corporations—2011

6.1 This chapter presents the main points of special examination reports of Crown corporations that were issued to the corporations' boards of directors between 1 January 2011 and 31 December 2011 and that have subsequently been made public. These reports were transmitted throughout the year, and the respective systems and practices were examined during different time periods.

Importance of Crown corporations

6.2 Crown corporations are distinct legal entities whose names, mandates, powers, and objectives are set out in either the constituent legislation for the parent Crown corporation or the articles of incorporation under the *Canada Business Corporations Act*. There are two types of Crown corporations: those that are wholly owned directly by the Government of Canada (parent Crown corporations) and those that are wholly owned by other Crown corporations (subsidiaries).

6.3 Crown corporations have more autonomy than most other government entities, in part, because they have commercial objectives as well as public policy objectives. They account for a significant portion of government activity and operate in many sectors of the Canadian economy, including transportation, energy, agriculture and fisheries, financial services, culture, and government services.

6.4 As of 31 December 2011, there were 46 parent Crown corporations and three subsidiaries that were directed to report as parent Crown corporations. These Crown corporations employed over 100,000 people. More than 83 percent of these employees worked at four corporations: Canada Post Corporation, Canadian Broadcasting Corporation, Atomic Energy of Canada Limited, and VIA Rail Canada Inc. The vast majority of Crown corporations had fewer than 3,000 employees. New Crown corporations are created periodically, but no new corporations were created in 2011.

6.5 Crown corporations manage more than \$375 billion in assets. Note that owing to the unique nature of their operations, total asset holdings for the Bank of Canada, the Canada Pension Plan Investment Board, and the Public Sector Pension Investment Board have not been included in the Crown corporations' total assets. Crown corporations fund their operations in a variety of ways. Some corporations are required by their enabling legislation to be financially self-sustaining and thus receive no parliamentary appropriations. Some are funded mainly through parliamentary appropriations. Others receive federal funding but also generate revenue. In the 2010–11 fiscal year, 27 corporations received just over \$6.7 billion in appropriations;

82 percent of these appropriations went to five corporations: Canada Mortgage and Housing Corporation, Canadian Broadcasting Corporation, Atomic Energy of Canada Limited, Canadian Air Transport Security Authority, and VIA Rail Canada Inc.

6.6 A board of directors or a similar governing body oversees the management of each corporation and holds management responsible for the corporation's performance. The board of a parent Crown corporation is, in turn, accountable to Parliament through the responsible minister.

Role of the Office of the Auditor General

6.7 Under Part X of the *Financial Administration Act*, the Auditor General is appointed to conduct annual audits of the financial statements and periodic special examinations of Crown corporations, either on his own or jointly with a private sector audit firm, unless he waives the appointment.

Definition and objective of a special examination

6.8 A special examination is an important accountability mechanism for Crown corporations. The objective of a special examination is to provide an independent opinion on whether there is reasonable assurance that a Crown corporation has systems and practices in place to ensure that its

- assets are safeguarded and controlled;
- financial, human, and physical resources are managed economically and efficiently; and
- operations are carried out effectively.

6.9 Any major weakness in the key corporate systems and practices that could prevent a corporation from achieving these objectives is reported as a **significant deficiency**. When planning special examinations, we conduct a risk analysis to identify the systems and practices that we consider essential to providing the corporation with this assurance. We also establish criteria that we use to examine the corporation's systems and practices. These criteria are based on our experience with performance auditing and our knowledge of the subject matter. They are selected in consultation with the corporation.

6.10 The opinion we present in the special examination can take one of three forms. First, we may find there is reasonable assurance that no significant deficiencies exist in the systems and practices the corporation maintains to achieve the objectives noted above. Second, we may find there is one or more significant deficiencies. Finally, in rare situations, we may find there is no reasonable assurance that a corporation's systems and practices achieve the objectives.

Significant deficiency—A major weakness in a Crown corporation's key systems and practices that could prevent it from having reasonable assurance that its assets were safeguarded and controlled, its resources were managed efficiently and economically, or its operations were carried out effectively.

6.11 The frequency of a special examination, as determined by the *Financial Administration Act*, is at least once every 10 years. However, special examinations could be carried out more frequently, if required by the Governor in Council (the Cabinet acting in a legal capacity), the appropriate minister, the board of directors of the corporation, or the Auditor General.

6.12 As part of the accountability mechanism for Crown corporations, the examiner reports on special examinations to the board of directors of a Crown corporation. Furthermore, the examiner may bring information from the special examination to the attention of the appropriate minister, after consulting with the board of directors. The examiner may also bring such information to Parliament's attention, after consulting with the appropriate minister and the board of directors, by preparing a report for inclusion in the next annual report of the corporation.

6.13 The *Financial Administration Act* requires that the board of directors submit all special examination reports to the appropriate minister and the President of the Treasury Board within 30 days of receiving them. The Act also requires that the board of directors make the reports available to the public within 60 days of receiving them.

Special examination results for 2011

6.14 Reports were issued for the following three Crown corporations between 1 January 2011 and 31 December 2011, and have been subsequently made public:

- Canadian Dairy Commission,
- Canadian Race Relations Foundation, and
- Public Sector Pension Investment Board.

6.15 No significant deficiencies were identified in these special examination reports.

6.16 In addition, the special examinations highlight systems and practices that contribute to success, and they provide information and recommendations to boards of directors about other opportunities for improvement. For these three Crown corporations, our recommendations focused primarily on corporate governance, strategic planning, and risk management. Because of the small number of special examination reports issued during this period, it is difficult to identify overall trends.

6.17 Since 2008, we have been reporting annually on the special examinations transmitted in each respective year. Cumulatively, we have reported on 29 special examinations of which 8 had significant

deficiencies and 18 did not. As noted earlier, these reports were transmitted to the respective boards of directors on different dates during each year, and the respective systems and practices were examined during different time periods. No follow-up audit work regarding any of the matters raised in these reports has been performed.

6.18 The next section provides the main points from each of the three special examination reports. Full reports can be found on each corporation's website.

Main Points of Special Examinations—2011

Canadian Dairy Commission—Main Points

[We issued the full report to the board of directors on 16 March 2011. The examination work covered the period from March 2009 to August 2010. For the full report and our recommendations, please go to www.cdc.ca or contact the Commission.]

What we examined

The Canadian Dairy Commission is a Crown corporation established in 1966 to coordinate the federal government's and the provinces' policies and roles in managing the dairy industry in Canada. Acting as both a facilitator and a stakeholder in various forums that influence Canadian dairy policy, the Commission supports the interests of all dairy stakeholders—producers, processors, exporters, consumers, and governments.

The Commission has about 65 employees. The federal government funds approximately half of its administrative costs. Other costs, including marketing activities, are funded by dairy producers and the marketplace.

The Commission reports to Parliament through the Minister of Agriculture and Agri-Food whom it advises on matters related to the dairy industry.

We examined whether the Canadian Dairy Commission's systems and practices provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. Our examination focused on areas important to all Crown corporations, such as corporate governance, risk management, and strategic planning, and on areas of particular importance to the Commission, such as determining support prices and market-sharing quotas. Our examination covered the systems and practices that were in place between March 2009 and August 2010.

Why it's important

In 2009, dairy production in Canada generated total net farm receipts of \$5.5 billion and sales of \$13.6 billion, representing 15 percent of the Canadian food and beverage sector, according to the Canadian Dairy Information Centre. The Canadian Dairy Commission plays a key role in ensuring that Canadians have a continuous supply of milk and other dairy products available and seeks to ensure that efficient producers have the opportunity to obtain a fair return on their labour and investment.

What we found

We found no significant deficiencies in the Commission's systems and practices. A significant deficiency is reported when there is a major weakness in the Commission's key systems and practices that could prevent it from having reasonable assurance that its assets are safeguarded and controlled, its resources are managed efficiently and economically, and its operations are carried out effectively.

We noted good practices in a number of areas. We also noted some areas where the Commission would benefit from improving its practices.

- The Commission has the key elements of an effective governance framework in place. The Board assumes stewardship of the Commission and works closely with management. Roles and responsibilities are clearly defined and understood, and the Board is supported by a simplified subcommittee structure. Some issues raised in our 2005 Special Examination Report have not been resolved—namely, it is difficult for the three-person Board to have the full range of skills needed for governance, and the Board does not have a process for directors to declare and manage conflicts of interest.
- The Commission manages its key operational functions well. Its practices for determining support prices and market-sharing quotas are consistent with its legislation and objectives. It also has systems and practices in place for protecting its inventory of butter and skim milk powder and for issuing permits under the Special Milk Class Permit Program.
- The Commission's management of human resources provides it with the core competencies and skills it needs as a small Crown corporation. It has recognized the need for succession planning. The work to prepare for future retirements is ongoing.

The Commission has responded. The Commission agrees with our recommendations.

Canadian Race Relations Foundation—Main Points

[We issued the full report to the board of directors on 16 September 2011. The examination work covered the period from November 2010 to April 2011. For the full report and our recommendations, please go to www.crr.ca or contact the Foundation.]

What we examined

The Canadian Race Relations Foundation is a Crown corporation founded in November 1997. It was created as part of the 1988 Japanese–Canadian Redress Agreement, which acknowledged that the treatment of Japanese–Canadians during and after World War II was unjust and violated principles of human rights. Under the terms of the Agreement, the federal government promised to create a Canadian Race Relations Foundation.

The Foundation’s operating income is derived primarily from the income earned by investing a one-time \$24 million endowment fund established by the Government of Canada when the Foundation was created. The *Canadian Race Relations Foundation Act* requires that the endowment itself be used solely for investment.

The Foundation reports to Parliament through the Minister of Citizenship, Immigration and Multiculturalism. It is governed by a board of directors and has six employees; its office is in Toronto. The Foundation’s activities are mainly outreach and awareness activities, which are intended to contribute to the elimination of racism and racial discrimination. They include media events, use of social media tools, award, and education and training programs.

We examined whether the Canadian Race Relations Foundation’s systems and practices provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. In this first special examination of the Foundation, we focused on the areas of governance, strategic planning and risk management, investment management, and operations. Our examination covered the systems and practices that were in place between November 2010 and April 2011.

Why it’s important

The Foundation’s mandate, as specified in the *Canadian Race Relations Foundation Act*, is to facilitate the development, sharing, and application of knowledge and expertise throughout Canada in order to contribute to the elimination of racism and all forms of racial discrimination in Canadian society. The Foundation supports the federal government’s commitments and responsibilities under the

International Convention on the Elimination of All Forms of Racial Discrimination and under Canadian law for equal participation in Canadian society and the elimination of discrimination.

What we found

We found no significant deficiencies in the systems and practices of the Canadian Race Relations Foundation. We noted good practices in a number of areas, and we also noted some practices that the Foundation would benefit from improving.

- The Foundation's Board of Directors has most of the elements necessary for effective governance. The Board's roles and responsibilities and those of the executive director are clearly defined, and the Board provides management with strategic direction and oversight. The Board has developed an effective working relationship with management, and has practices in place to maintain its independence. However, the Board competency profile has not been updated since March 2009, and that profile did not reflect the specific skills and experience required on the Board. In particular, the profile did not identify the extent of investment management expertise the Foundation needs to oversee the portfolio that provides the majority of its income.
- The Foundation has most of the elements necessary to manage its investment portfolio. Its investment policy includes all the key elements necessary to guide the Foundation's investment strategy, and the activities of three fund managers are overseen by an investment advisor and the Board. However, management and the Board need more complete performance information to better monitor the investment portfolio.
- The Foundation's strategic planning process sets clear direction for its operations. Planning of activities is mainly done through the development of the business plan, which aligns the activities with the Foundation's strategic plan and mandate, and includes information that allows them to be monitored by management and the Board. The Foundation also identified its major organizational risks and developed action plans to mitigate them, which management started to implement. However, there has been no review of the actions taken or their effectiveness in mitigating the risks.

The Foundation has responded. The Foundation agrees with all of the recommendations.

Public Sector Pension Investment Board—Main Points

[This examination was jointly completed with Deloitte & Touche LLP. We issued the full report to the board of directors on 12 May 2011. The examination work covered the period from June 2010 to November 2010. For the full report and our recommendations, please go to www.investpsp.ca or contact the Corporation.]

What we examined

The Public Sector Pension Investment Board (PSP Investments or the Corporation) is a Crown corporation created to invest the pension contributions (net of benefit payments made) of the Public Service, Canadian Forces, Royal Canadian Mounted Police, and Reserve Force pension plans (the Plans). Its mandate is to manage and invest these funds in the best interests of the contributors and beneficiaries, with a view to achieving a maximum rate of return, without undue risk of loss, having regard to the funding, policies and requirements of the pension plans.

We examined whether PSP Investments' systems and practices provide the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. We focused on the areas of governance, risk management, strategic planning, performance measurement, investment management, human resource management, and information technology management. Our examination covered the systems and practices that were in place between June 2010 and November 2010.

Why it's important

Net contributions from the plan members and sponsors which are transferred to PSP Investments represent an important portion of the assets which will serve to pay benefits of plan members upon their retirement. Ineffective systems and practices could lead to diminished returns and erosion of capital, potentially compromising the plans' ability to meet their financial obligations.

What we found

We found no significant deficiencies in the Corporation's systems and practices. This means that the Corporation maintains systems and practices that provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. A significant deficiency is reported when there is a major weakness in the Corporation's key systems and practices that could prevent it from having that reasonable assurance. We noted good practices in most areas, as well as some areas where PSP Investments would benefit from certain improvements.

- The Corporation has the key elements of a strong governance framework, and its governance practices are consistent with industry practices for stewardship and oversight by boards of directors. However, the lack of the staggering of appointments to the Board of Directors, which is not under the control of PSP Investments, may potentially lead to significant turnover in the Board membership in 2014 and 2015.
- The Corporation's risk management practices, particularly in the area of investment risk, provide for identification, monitoring, management, and reporting of risks to protect its assets from undue risk of loss. The Corporation continues to develop its risk measurement and risk management capabilities, in line with industry practice.
- The Corporation's compensation framework and practices are comparable with those of the industry. Incentives for investment staff are designed to balance the need to attract and retain talented performers with the need to align behaviours with the Corporation's investment strategies, policies, and risk tolerances. Staff engaged in risk and compliance functions are compensated in a manner that maintains their independence from the areas they oversee. The Board plays an active oversight role in the design and operation of compensation practices, and reviews and monitors them independently of management.
- The Corporation regularly benchmarks its practices against those of comparable organizations in the industry. Its practices in most areas are consistent with those of the industry. However, improvements can be made in public reporting of its Responsible Investment activities in order to better align with industry practices in this area.

The Corporation has responded. The Corporation agrees with all the recommendations.

About the Chapter

Objective

The objective of this chapter was to bring to the attention of Parliament the results of the Office of the Auditor General's special examination reports that were transmitted to the boards of directors of Crown corporations between 1 January 2011 and 31 December 2011. The Crown corporations have subsequently made these reports public.

Scope and approach

The chapter includes the main points of two special examinations where the Auditor General was the examiner, and one special examination where the Auditor General was the joint examiner.

The approach to this chapter consisted of presenting information that was already public, providing information about what a special examination is, and presenting the main points of the three special examinations.

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